

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:FIP:B02
PLR-116639-09

Date:
September 22, 2009

Legend:

Fund =

State A =

Date 1 =

a =

Dear :

This responds to your letter dated March 20, 2009, submitted by your authorized representative on behalf of Fund. Fund requests that the Internal Revenue Service rule that cancellation of indebtedness income (COD income) arising from the repurchase of its notes constitutes qualifying income under § 851(b)(2) of the Internal Revenue Code of 1986, as amended (the Code).

Facts:

Fund is a State A corporation registered as a business development company under the Investment Company Act of 1940, 15 U.S.C. 80a-1 et seq., as amended (the 1940 Act). Fund uses an overall accrual method of accounting and the calendar year as its taxable year. Fund has elected to be, and intends to qualify each year as a regulated investment company (RIC) under § 851(a) of the Code.

Fund's investment objectives are to generate both current income and capital appreciation through debt and equity investments by primarily investing in U.S. middle market companies, where Fund believes the supply of primary capital is limited.

On Date 1, through entities disregarded from Fund for federal income tax purposes, Fund issued notes (the Notes) generating net proceeds of approximately \$a. Fund used the \$a to purchase, through disregarded entities, a diversified portfolio of loans meeting specific investment criteria (the Loans). Fund represents that the net proceeds of \$a from the issuance of the Notes are directly traceable to the purchase of the Loans within the meaning of section 1.163-8T of the Income Tax Regulations.

Although the Notes are not traded on any exchange, holders do offer the Notes for sale through private brokers. Due to the current ongoing credit crisis (and not due to any delinquency on the part of Fund), the Notes are currently being sold at substantial discounts from their adjusted issue prices.

Because the Notes are selling at substantial discounts, Fund believes it is in the best interests of its shareholders to repurchase the Notes. Fund represents that any repurchase will be in compliance with the 1940 Act and Fund's investment objectives, policies and procedures. Fund will recognize COD income upon the repurchase of the Notes, which may exceed 10% of Fund's annual gross income.

Law and Analysis:

Section 851(b)(2) of the Code provides that a corporation shall not be considered a RIC for any taxable year unless it meets an income test. Under this test, at least 90 percent of its gross income must be derived from certain enumerated sources. Section 851(b)(2) defines qualifying income, in relevant part, as –

dividends, interest, payments with respect to securities loans (as defined in section 512(a)(5)), and gains from the sale or other disposition of stock or securities (as defined in section 2(a)(36) of the 1940 Act) or foreign currencies, or other income (including but not limited to gains from options, futures or forward contracts) derived with respect to [the RIC's] business of investing in such stock, securities, or currencies

Section 2(a)(36) of the 1940 Act defines the term "security" as –

any note, stock, treasury stock, security future, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or

privilege on any security (including a certificate of deposit) or on any group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a “security”, or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

Section 1.163-8T prescribes rules for allocating interest expense for purposes of applying § 469 (the “passive loss limitation”) and §§ 163(d) and (h) (the “nonbusiness interest limitations”). Section 1.163-8T(a)(3) provides in general that interest expense on a debt is allocated in the same manner as the debt to which such interest expenses relates is allocated. Debt is allocated by tracing disbursements of the debt proceeds to specific expenditures under the rules prescribed by section 1.163-8T.

COD income is not specifically enumerated as one of the items of gross income in § 851(b)(2). However, Fund’s COD income may be qualifying income under § 851(b)(2) if it is “other income” that is derived with respect to Fund’s business of investing in securities. In determining whether certain income of a RIC is derived with respect to the RIC’s business of investing in securities, there must be a direct connection between the “other income” and the RIC’s business of investing in securities.

In order to demonstrate a direct connection between Fund’s COD income and Fund’s business of investing in securities, Fund represents that the proceeds of the Notes can be traced, within the meaning of section 1.163-8T(a)(3), to the purchase of the Loans. Fund further represents that the Loans are securities for purposes of § 851(b)(2).

Authorities under section 1.163-8T are not controlling for purposes of § 851(b)(2), but may provide useful guidance in interpreting substantially similar concepts arising under § 851(b)(2). Although Fund is not required by § 851(b)(2) to trace the proceeds of the Notes to the purchase of the Loans, the ability to trace is one way to demonstrate the direct connection between the COD income and Fund’s business of investing in the Loans.

Conclusion:

Based on the facts as represented, we rule that, to the extent the proceeds of the Notes can be traced to the purchase of the Loans within the meaning of section 1.163-8T(a)(3), the COD income from the repurchase of the Notes is qualifying income for purposes of § 851(b)(2) because the COD income is other income derived with respect to Fund’s business of investing in securities.

Except as expressly provided herein, no opinion is expressed concerning any federal income tax consequences related to the facts herein under any other provisions

of the Code. Specifically, we express no opinion as to whether Fund qualifies as a RIC, or whether the net proceeds from Fund's issuance of the Notes are directly traceable to the purchase of the Loans within the meaning of section 1.163-8T of the regulations.

This ruling is directed only to the taxpayer who requested it, and is limited to the facts as represented by the taxpayer. Section 6110(k)(3) provides that this letter may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Susan Thompson Baker
Susan Thompson Baker
Assistant to the Branch Chief, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)